

RICHARD J. PHILLIPS, CPA

Review Report

QUALITY CONTROL REVIEW

For the CPA's Audit of
Kern County Superintendent of Schools
for the Fiscal Year Ended June 30, 2002



STEVE WESTLY
California State Controller

May 2004



STEVE WESTLY
California State Controller

May 28, 2004

Richard J. Phillips, CPA
2019 Westwind Drive, Suite B
Bakersfield, CA 93301

Dear Mr. Phillips:

The State Controller's Office has completed a quality control review of Richard J. Phillips, CPA. We reviewed the audit working papers for your audit of Kern County Superintendent of Schools for the fiscal year ended June 30, 2002.

A draft report was issued on March 26, 2004. As you stated in a telephone conversation on May 20, 2004, you will not respond to the draft report.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

A handwritten signature in dark ink that reads "Vincent P. Brown". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

VINCENT P. BROWN
Chief Operating Officer

VPB:ams/jj

cc: Dr. Larry E. Reider, Superintendent
Kern County Office of Education
Arlene Matsuura, Educational Consultant
School Fiscal Services Division
California Department of Education
Charles Pillsbury
School Apportionment Specialist
Department of Finance

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Review Report

Summary

The State Controller's Office (SCO) has completed a quality control review of the audit working papers for an audit performed by Richard J. Phillips, CPA, of the Kern County Superintendent of Schools for the fiscal year ended June 30, 2002 (FY 2001-02). The last day of fieldwork was June 19, 2003.

The audit referred to above was performed in accordance with some elements of the standards and requirements set forth in *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted government auditing standards (GAGAS); U.S. generally accepted auditing standards (GAAS); Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO. However, the majority of auditing standards and requirements were not met. The basis for this opinion is that the CPA:

- Did not comply with GAAS and GAGAS with regard to due professional care, fieldwork, sampling, continuing professional education, independence, and audit planning;
- Did not comply with the K-12 Audit Guide with regard to state compliance testing and reporting; and
- Failed to follow federal single audit requirements for determination of testing major programs.

Background

Any governmental unit subject to a single audit must have the audit performed in accordance with the standards referred to in this report. According to OMB Circular A-133, the auditor's work is subject to a quality control review at the discretion of an agency granted cognizant or oversight status by the federal funding agency. In addition, *Education Code* Section 14504.2 authorizes the SCO to perform quality control reviews of working papers for audits of K-12 local educational agencies (LEAs) to determine whether audits are performed in accordance with U.S. General Accounting Office standards for financial and compliance audits.

Richard J. Phillips is a certified public accountant with an office located in Bakersfield, California. The CPA has been the independent auditor for Kern County Superintendent of Schools (KCSOS) since FY 1992-93. KCSOS is a fiscally independent agency that provides direct support services to Kern County's 47 school districts along with fiscal oversight as specified in AB 1200, enacted by the California Legislature in 1992. KCSOS also provides direct instructional services to students with mental and physical disabilities. Other direct instructional services are provided to incarcerated youth, and those on probation or deemed at risk

of failing or dropping out of school. Together the direct instructional programs provide services to students in preschool through eighth grade. KCSOS operates stand-alone school sites and classrooms housed in many school district campuses throughout Kern County, with a total average daily attendance (ADA) of 3,085 for the purpose of state funding.

The CPA performed two annual financial audits of LEAs for FY 2001-02.

Objectives, Scope, and Methodology

The general objectives of the quality control review were to determine whether this audit was conducted in compliance with:

- GAGAS
- GAAS
- K-12 Audit Guide
- OMB Circular A-133

The quality control review was conducted at the office of Richard J. Phillips. The SCO reviewers compared the audit work performed by the CPA, as documented in the working papers, with the standards stated in the general objectives.

Conclusion

The audit referred to above was performed in accordance with some elements of the standards and requirements set forth in GAGAS, GAAS, OMB Circular A-133, and the K-12 Audit Guide; however, the majority of auditing standards and requirements were not met. The basis for this opinion is discussed in the Findings and Recommendations section of this report.

This report is applicable solely to the audit working papers referred to above and is not intended to pertain to any other work of Richard J. Phillips, CPA.

Views of Responsible Official

The SCO issued a draft report on March 26, 2004. Mr. Phillips responded through a telephone conversation on May 20, 2004, stating that he would not be sending a response to the draft report.

Restricted Use

This report is intended solely for the information and use of the specified parties; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.



JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

Findings and Recommendations

General

The Single Audit Act and the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO, require audits to be performed in accordance with U.S. generally accepted auditing standards (GAAS). These standards deal with the quality of the audits performed by the independent auditor and have been approved and adopted by the American Institute of Certified Public Accountants (AICPA). GAAS is divided into three areas: (1) general standards; (2) fieldwork standards; and (3) reporting standards. The three areas are divided into ten specific standards. In addition to GAAS, auditors of governmental entities must also perform audits in accordance with generally accepted government auditing standards (GAGAS), which expands the GAAS standards in several areas.

In the course of this quality control review, the SCO reviewers found that Richard J. Phillips, CPA, did not comply with the majority of the GAAS and GAGAS standards.

In addition, the CPA did not comply with state compliance testing requirements found in the K-12 Audit Guide and the single audit requirements for federal programs.

Noncompliance With General Standards (GAAS, GAGAS)

FINDING 1— Due professional care/working paper deficiencies

The CPA did not prepare lead sheets or other documents to reconcile financial statement assertions with supporting documentation for revenue, receivables, and accounts payable as follows:

- Revenue received was verified by tracing amounts listed on the Schedule of Special Projects report (\$103,467,469) to supporting documents. However, the total revenue reported as received in the audit report (\$189,705,663) exceeds the Schedule of Special Projects report by \$86,238,194.
- General fund revenue reported in the audit report could not be traced to supporting working papers. The audit report indicated a total of \$94,616,890 while the KCSOS unaudited actual report indicated total revenue of \$94,590,162, a difference of \$26,729. This is the amount of funding received for the Forest Reserve program as pass-through funding. There was no evidence in the working papers that the CPA had verified the amount of funding received for the Forest Reserve program.
- The working paper used to document the total of receivables by category indicated the total of receivables was \$10,433,584 for the general fund. The audit report listed receivables for the general ledger report as \$12,324,530, a difference of \$1,890,946.
- The working papers contained a summary of accounts payable (\$14,514,773) that did not agree to the audit report (\$20,275,423).

The following working paper deficiencies were also noted:

- Working papers contained a comparison of budgeted revenue to actual revenue received. However, the working papers did not include any evidence the CPA had reviewed or investigated any variances. For example, the total revenue for resource 8290 (All Other Federal Revenue) was \$8,900,608 less than the final budget, but there was no explanation for the variance.
- There was no documentation that the CPA had assessed cash disbursement procedures to ensure controls, such as segregation of duties and management approval or supervision, were implemented to prevent misappropriation of assets. Some substantive tests of program expenditures were performed as part of federal compliance testing but the working papers contained no documentation of the procedures purportedly performed.
- There was no documentation that the monthly/annual payroll records were examined and tested. KCSOS provides support services to school districts within Kern County by processing payroll warrants and reviewing payroll records for accuracy, as well as processing its own payroll. Effectively, KCSOS has become a service organization, providing services to districts within Kern County. The working papers contained no evidence that the county's internal control over their payroll process had been documented or analyzed for risk. As a service organization, the county's payroll procedures and associated controls should have received additional scrutiny by the CPA.
- Documents used as evidence in the working papers did not consistently include the nature and source. Documents such as the ratio calculation of teachers to students and a detail of revenue, Schedule of Special Projects, did not include the source, so it was not possible to determine who had prepared the information. For example, three of the seven spreadsheets prepared for federal compliance testing did not include a description of the source of the data, so it was not possible to trace the information to the original source.

GAGAS and GAAS contain several standards regarding the due professional care the auditor should take when performing the audit.

GAGAS 3.28 states:

Exercising due professional care means using sound judgment in establishing the scope, selecting the methodology, and choosing tests and procedures for the audit. The same sound judgment should be applied in conducting the tests and procedures and in evaluating and reporting the audit results.

AU Section 230.04 states, in part:

The matter of due professional care concerns what the independent auditor does and how well he or she does it.

If the auditor fails to exercise due professional care in the performance of an audit, the work performed may be unreliable and the judgments made and conclusions reached by the CPA cannot be evaluated as accurate or valid. Consequently, the auditor's opinion on the financial statements may not be correct.

Recommendation

The CPA should comply with GAAS and GAGAS with regard to performing the audit using due professional care. This care would extend to the work performed as well as the preparation of the working papers and audit report. Any audit procedures performed should be sufficiently documented in the working papers to allow another CPA to review the work performed and ascertain the evidence supporting the CPA's significant conclusions and judgments.

Noncompliance With Fieldwork Standards for Financial Audits (GAAS, GAGAS)

FINDING 2—

The working papers did not contain sufficient competent evidential matter to support the CPA's conclusions in three areas.

General Long Term Debt

The working paper documentation did not provide evidence the CPA adequately tested long-term debt to ensure KCSOS had met all obligations and all debts were fully and accurately disclosed in the audit report. The working papers contained no evidence that the CPA:

- Verified the outstanding balance of all liabilities.
- Determined that all debt service payments were made as shown in Notes 7 and 10 of the annual audit report.
- Verified that the capital lease payments were made.

In addition, the Statement of Revenues, Expenditures, and Changes in Fund Balance for the General Fund, on page 14 of the audit report, did not indicate any debt service payments other than for certificates of participation. If the capital lease payments and child care facility loan payments were reported as capital outlay, the CPA should have reclassified the principal and interest charges to the proper accounts for presentation in the audit report (*California Schools Accounting Manual* Procedure No. 805).

Revenues

The working papers did not provide evidence that the substantive tests of income were adequate to ensure revenue was accurately reported. The following deficiencies were noted:

- Working papers did not include a reconciliation of revenue, deferred revenue, or restricted fund balance.
- Revenue reported in the audit report could not be traced to the working papers (as noted in Finding 1).
- Working papers contained documentation that the CPA had compared the budget projection for revenue to the actual revenue received. However, the working papers contained no evidence or documentation that the CPA investigated any variances (as noted in Finding 1).

Expenditures

There was no evidence the CPA had assessed cash disbursement procedures, including payroll, to ensure controls such as segregation of duties and management approval/supervision were implemented to prevent misappropriation of assets. Some substantive tests of program expenditures were performed, as part of federal compliance testing, but the working papers contained no documentation of the procedures purportedly performed. Deficiencies noted were as follows:

- The working papers contained no evidence that the revolving account expenditures had been examined or how the controls over the revolving account were determined to be adequate.
- The working papers contained no evidence that the CPA had tested any item accrued in accounts payable as of June 30, 2002, and reported as received between June 30, 2002, and November 15, 2002, to determine the validity of the items.
- The working papers contained evidence the CPA tested 22 payroll transactions as part of federal expenditure compliance testing. A report of federal program expenditures was used to select the transactions; however, there was no supporting documentation that the monthly/annual payroll records had been examined to determine the accuracy or validity of the amounts being tested.
- The working papers contained no documentation that the CPA had assessed internal controls over the cash disbursement process.

GAAS and GAGAS contain several standards regarding evidential matter that the auditor should follow when performing the audit and documenting the work performed to support the auditor's conclusion.

AU Section 319.79 states:

... The auditor uses this evidential matter as part of the reasonable basis for an opinion referred to in the third standard of field work, which follows:

Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

AU Section 326.13 regarding evidential matter states:

... The evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements.

AU Section 339.01 states:

The auditor should prepare and maintain working papers, the form and content of which should be designed to meet the circumstances of a particular engagement. The information contained in the working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters.

AU Section 339.02 states:

Working papers serve mainly to – a. Provide the principal support for the auditor's report, including his representation regarding observations of the standards of fieldwork, which is implicit in the reference in his report to generally accepted auditing standards. – b. Aid the auditor in the conduct and supervision of the audit.

AU Section 339.05 states:

... they should be sufficient to show that the accounting records agree or reconcile with the financial statements or other information reported on and that the applicable standards of field work have been observed.

GAGAS Section 4.35 states

... Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

GAGAS Section 4.37 states:

Working papers should contain:

- a. The objectives, scope, and methodology, including sampling criteria used;
- b. Documentation of the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records; and
- c. Evidence of supervisory review of the work performed.

GAGAS Section 4.37(b) states:

Working papers should contain documentation of the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records. . . .

Without sufficient evidential matter, the judgments made and conclusions reached by the CPA cannot be evaluated as accurate or valid. Without adequate documentation, errors or inadequacies of the work performed may not be detected and corrected. Consequently, the auditor's opinion on the financial statements and state and federal compliance may not be correct.

Recommendation

The CPA should comply with GAAS and GAGAS with regard to obtaining evidential matter and documenting the work performed. Any audit procedures performed should be sufficiently documented in the working papers to allow another CPA to review the work performed and ascertain the evidence supporting the CPA's significant conclusions and judgments.

FINDING 3— Sampling deficiencies

The CPA did not consistently relate the size of samples selected to the total population size, account balance, class of transaction, other relevant audit evidence, or control risk assessments. When the description of the sampling method used was included in the working papers, the description was not accurate. For example, the working paper prepared to document the testing of the child development fund stated that expenditures were "randomly" selected; however, there was no evidence that a random number table or computer-generated random numbers were used to select the sample. It appears haphazard sample selection techniques were used. The working paper prepared to document the testing of accounts payable did not include any description of the total population or the method used to select the sample items for testing.

Within sample selections and related testing, attributes being tested or what constituted an error were not documented. For example, the working paper prepared to document the search for unrecorded liabilities stated the CPA "reviewed July and August expenditures excluding payroll items for any large or unusual items." However, no criteria or definition of what was considered a "large item" was included in the documentation of procedures performed or attributes tested.

AU Section 350.23 states:

To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should consider the tolerable misstatement, the allowable risk of incorrect acceptance, and the characteristics of the population. An auditor applies professional judgment to relate these factors in determining the appropriate sample size.

AU Section 350.16 states:

When planning a particular sample for a substantive test of details, the auditor should consider . . . characteristics of the population, that is, the items comprising the account balance or class of transactions of interest.

AU Section 350.24 states:

Sample items should be selected in such a way that the sample can be expected to be representative of the population.

AU Section 350.29 states:

The auditor should relate the evaluation of the sample to other relevant audit evidence when forming a conclusion about the related account balance or class of transaction.

If sample size and items selected are not appropriate, the CPA's conclusions may not be accurate.

Recommendation

In selecting a sample, the CPA should use a method that considers the characteristics of the population such as size, account balance, and transaction class. In addition, consideration should be given to other variables such as tolerable misstatement, allowable risk of incorrect acceptance, and control risk assessment. The CPA should accurately document the method used and adequately justify that the sample selected is representative of the population and supports the conclusion drawn.

Noncompliance With Generally Accepted Government Auditing Standards (GAGAS)

FINDING 4— Continuing professional education deficiencies

The CPA did not comply with standards for continuing professional education (CPE) for the two-year period of August 31, 1999, to August 31, 2001. The CPA did not complete 20 CPE hours during the first 12-month period. The CPA completed 82 CPE hours in the six-month period of February 2001 through August 2001.

GAGAS 3.6 states, in part:

To meet this standard, the audit organization should have a program to ensure that its staff maintain professional proficiency through continuing education and training. Thus, each auditor responsible for planning, directing, conducting, or reporting on audits under these standards should complete, every 2 years, at least 80 hours of continuing education and training which contributes to the auditor's professional proficiency. At least 20 hours should be completed in any 1 year of the 2-year period.

Recommendation

The CPA should comply with CPE requirements as stipulated in governmental auditing standards.

**FINDING 5—
Lack of independence**

The CPA is a sole proprietor, and he has one assistant. No internal policy exists which requires them to sign or attest that they are both free from personal and external impairments, are organizationally independent, and will maintain an independent attitude and appearance. In addition, the issue of independence is not addressed in the engagement letter, contract, or any other document.

GAGAS 3.11 states:

In all matters relating to audit work, the audit organization and the individual auditors, whether government or public, should be free from personal and external impairments to independence, should be organizationally independent, and should maintain an independent attitude and appearance.

Recommendation

To address any concerns regarding independence, the CPA and his assistant should complete a statement of independence annually or include a statement in the engagement letter as evidence that independence (or lack thereof) was considered prior to performing the audit.

**FINDING 6—
Inadequate planning**

The engagement letter prepared by the CPA did not specify the financial statements to be audited, nor does it specify all individual reports to be prepared. The engagement letter did not specify that the CPA would prepare a report on state compliance and report on compliance with requirements applicable to Proposition 10 programs and internal control over compliance in accordance with OMB Circular A-133.

GAGAS Section 4.6.6 states:

During the planning stages of an audit, auditors should communicate their responsibilities in a financial statement audit, including their responsibilities for testing and reporting on compliance with laws and regulations and internal control over financial reporting. Such communication should include the nature of any additional testing of compliance and internal control required by laws and regulations or otherwise requested, and whether the auditors are planning on providing opinions on compliance with laws and regulations and internal control over financial reporting.

Recommendation

The CPA should follow GAGAS when planning the audit by informing the LEA of his responsibilities for testing and reporting compliance with laws and regulations and internal control over financial reporting.

Noncompliance With K-12 Audit Guide Requirements

FINDING 7— State compliance testing inadequate

The working papers did not contain evidence that the CPA performed all procedures contained in the K-12 Audit Guide. Working papers were not provided or documentation supporting the CPA's testing was inadequate for the following ten state compliance programs.

Attendance Reporting

Procedure 4 in the K-12 Audit Guide requires the auditor to test a representative number of teachers to determine if each of the teachers possessed a valid certification. On the program, the CPA commented, "Teachers possessed valid certification." The program contained no reference to a working paper. Examination of the working papers revealed no evidence that procedures included on the audit program and stated in the report on state compliance were performed. There was no documentation as to the number and names of teachers selected for testing.

Regional Occupational Center/Program (ROC/P)

It was not possible to determine from the working papers whether the CPA performed the audit procedures for the ROC/P. Examination of the working papers did not provide evidence the procedures were performed as stated in the report on state compliance. In addition, for the FY 2001-02 audit report, the CPA stated that five audit procedures were performed. However, for FY 2001-02, the K-12 Audit Guide and report format contained only four suggested audit procedures. The CPA incorrectly used the FY 2000-01 report format as the report on state compliance. This report, which was originally submitted to the SCO and subsequently rejected, showed that the CPA applied five audit procedures for testing ROC/P.

County Offices of Education

The CPA also incorrectly used the FY 2000-01 report format to show that juvenile court school and county community school programs were audited even though these programs were eliminated from the K-12 Audit Guide for FY 2001-02. The report on state compliance, which was originally submitted to the SCO and subsequently rejected, showed that the CPA applied nine audit procedures for testing these programs.

Independent Study

The working papers did not contain sufficient documentation to support the independent study ADA reported on the J-27/28 report of attendance had been reconciled to the superintendent's records. Also, the working papers did not contain evidence the CPA verified that certified employees generally supervised the independent study students as required by procedure 2e. The report on state compliance and the audit program indicated the CPA had performed all 13 procedures suggested in

the K-12 Audit Guide. The audit program reference showed “x workpapers” for all procedures. There was no reference to any specific working paper where the procedures had been performed and/or documented.

Staff Development

A calendar for KCSOS was included in the working papers, but it contained no evidence the CPA reviewed the calendar to determine if any day claimed as a staff development day was scheduled on an instructional day that was used for apportionment attendance purposes. In fact, the calendar indicated only one “inservice” day was scheduled, and it appeared the training was scheduled for a day used for apportionment attendance. The report on state compliance states that three audit procedures were performed to test KCSOS’s compliance with staff development requirements. In addition, on the audit program, the CPA initialed as performing only one procedure. The audit program contained no reference to any working paper and no other documentation was provided.

Community Day Schools

A working paper containing attribute descriptions indicated the CPA had verified compliance requirements listed in the FY 2000-01 K-12 Audit Guide. However, no evidence could be found in the working papers that the CPA performed all of the FY 2001-02 audit procedures. The working papers contained no evidence the CPA:

- Examined a bell schedule to determine that the school day included a least 360 minutes of classroom instruction;
- Tested teacher credentials to determine that students were provided classroom instruction by certificated teachers; and
- Verified ADA claimed for additional funding for fifth through eighth hour instructional day.

The audit program reference note only stated “see x workpapers.” There was no reference to any specific working paper where the procedures had been performed or documented. A copy of the J-27/28 report of attendance was in the working papers, but it did not contain a reference to a working paper where the ADA had been verified. The report on state compliance stated that eight audit procedures were performed to test compliance to requirements for community day school funding; however, on the audit program, the CPA initialed as performing four procedures.

State Instructional Materials

It does not appear that the CPA performed the four audit procedures on page 99 in the FY 2001-02 K-12 Audit Guide to test compliance with program requirements. The CPA marked “N/A” on these procedures although the report on state compliance indicated these procedures were

performed. In addition, the working papers did not include any evidence the CPA:

- Verified that at least 70% of the allowance was used to purchase instructional materials adopted by the State Board of Education;
- Determined that KCSOS provided a ten-day written notice of the hearing;
- Determined whether the notice included the time, place, and purpose of the hearing and was posted in at least three public places; and
- Determined that KCSOS maintained the instructional material allowance in a separate account.

The FY 2001-02 K-12 Audit Guide and report format contained ten audit procedures to test compliance with the state instructional materials program for grades K-8, and seven audit procedures to test compliance for grades 9-12. The CPA used the FY 2000-01 report format as the report on state compliance. This report, which was originally submitted to SCO and subsequently rejected, showed that the CPA applied eight audit procedures for testing instructional materials.

Schiff-Bustamante Standards-Based Instructional Materials

A list of textbooks purchased in the 2001-02 school year using Schiff-Bustamante funds was included in the working papers; however, this list was not indexed and there was no indication as to the source of the document. In addition, there was no indication that the books were determined to be on the list of materials adopted by the State Board of Education as procedure 3 in the K-12 Audit Guide required. The audit program contained no reference to any working paper.

Digital High School (DHS)

KCSOS received DHS funds. There is no indication in the working papers that the CPA determined the status of the DHS program as required by procedure 1 in the K-12 Audit Guide. In addition, there was no evidence in the working papers that the CPA performed procedures 4 and 5 other than the CPA's initials on the audit program. In particular, there was no evidence that the CPA selected a representative sample of DHS program expenditures to test for compliance (procedure 5) as there was no working paper to support the testing. The report on state compliance indicated that the CPA performed all five audit procedures.

California Public School Library Act

A copy of the 2001-02 library plan was included in the working papers. A comment had been written that the CPA had "tested a representative sample of expenditures/acceptable." However, there was no evidence of testing in the working papers. It was not possible to determine how the sample selection was performed or how the materials were determined to

be compliant with the library plan. The audit program contained no reference to any working paper.

The K-12 Audit Guide, Section 510, states, in part:

All state requirements identified in Section 520 that are applicable to the entity must be tested for compliance with state laws and regulations.” In addition, “each compliance requirement is accompanied by suggested audit procedures that can be utilized as determined by the auditor’s professional judgment.

GAGAS 4.35 states:

Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors’ significant conclusions and judgments.

AU Section 339.01 states:

The auditor should prepare and maintain working papers. The information contained in the working papers constitutes the principal record of the work that the auditor has done and the conclusions that he/she has reached concerning significant matters.

AU Section 339.02 states:

Working papers serve mainly to – a. Provide the principal support for the auditor’s report, including his representation regarding observations of the standards of fieldwork, which is implicit in the reference in his report to generally accepted auditing standards. – b. Aid the auditor in the conduct and supervision of the audit.

Noncompliance may not be detected if state compliance procedures are not performed adequately and accurately. Consequently, the CPA’s opinion on compliance may be inaccurate because it is based on insufficient evidential matter.

Recommendation

The CPA should ensure that the working papers provide sufficient documentation to support the auditor’s conclusions and judgments. The CPA should follow all professional standards, including due professional care standards, when performing audits of local educational agencies. All procedures in the K-12 Audit Guide should be performed or the working papers should provide documentation as to the rationale for why procedures were not performed.

**FINDING 8—
Reporting deficiencies**

The auditor's report on state compliance lists all the programs to be tested for state compliance requirements and the number of audit procedures for each program. The auditors are directed to provide an explanation in the report when a program is not tested, an audit procedure is not followed, or an alternate procedure is performed (*Education Code* Section 14503(a)).

As shown in Finding 7, the CPA's original report on state compliance incorrectly stated that the CPA performed testing for four programs: ROC/P, County Offices of Education, Community Day Schools, and State Instructional Materials. The original report also showed that procedures were performed for the Office of Criminal Justice Planning (OCJP) and for state residency requirements. With regard to OCJP, there was no evidence in the working papers that any procedures were performed; however, the audit report did include a schedule detailing revenues and expenditures for OCJP grants. The report on state compliance showed "N/A" for procedures in the K-12 Audit Guide and "yes" for procedures performed. State residency testing has not been included in the K-12 Audit Guide since 1997. There was no evidence in the working papers that state residency was tested. This report was subsequently revised, after being rejected during the SCO report certification process, to reflect the correct number of procedures for each state compliance program.

In addition, although the CPA submitted a revised report on state compliance, the working papers did not provide evidence to support that the CPA performed all of the audit procedures. Again, as noted in Finding 7, evidence was not provided to support that all procedures related to Attendance Reporting, ROC/P, Independent Study, Staff Development Days, Community Day School, State Instructional Materials, Schiff-Bustamante Standards-Based Instructional Materials, Digital High School, and California Public School Library were performed. Consequently, the report on state compliance did not accurately reflect the work performed by the CPA.

Education Code Section 14503(a) states, in part:

Financial and compliance audits shall be performed in accordance with General Accounting Office standards for financial and compliance audits. The audit guide prepared by the Controller shall be used in the performance of these audits. Every audit report shall specifically and separately address each of the state compliance program requirements included in the audit guide, stating whether or not the district is in compliance with those requirements. For each state program compliance requirement included in the audit guide, every audit report shall further state that the suggested audit procedures included in the audit guide for that requirement were followed in the making of the audit, if that is the case, or, if not, what other procedures were followed. . . .

Recommendation

The CPA should include in the auditor's report on state compliance the actual number of procedures performed for each program and, if not all procedures were performed, an explanation as to why any were not performed and/or a description of any alternate procedures performed. In addition, as discussed in Finding 1, the CPA should exercise due professional care in the preparation of the audit report.

Noncompliance With Federal Single Audit Requirements

FINDING 9— Lack of determination of major programs

The CPA did not evaluate Type B programs, i.e., programs with expenditures that exceed the "small program floor" but do not exceed the threshold for Type A programs. The CPA only performed a risk evaluation on Type A programs, programs that exceeded 3% (.03) of total federal awards expended.

The CPA completed a low-risk federal program determination worksheet to assess the risk level for five Type A programs. All five programs were determined to be low-risk. The CPA selected three of the five low-risk Type A programs as major programs. The CPA then tested the three low-risk Type A programs for compliance to applicable program requirements.

The CPA treated the low-risk Type A programs as major programs; therefore, OMB Circular A-133, Section 520(d)(2), required a risk evaluation of all programs that exceed the "small program floor." The program floor for KCSOS was \$126,926. KCSOS had eleven programs that met the requirement for risk evaluation. However, the CPA did not evaluate any of the Type B programs to determine if any were high-risk.

OMB Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations*, requires federal programs to be evaluated as follows:

§___.520 Major program determination. . . .

(b) Step 1. (1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:

(i) 300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed \$300,000 but are less than or equal to \$100 million. . . .

(c) Step 2. (1) The auditor shall identify Type A programs which are low-risk. . . .

(d) Step 3. (1) The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in §___525. However, should the auditor select Option 2 under Step 4 . . . , the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. . . .

(2) The auditor is not expected to perform risk assessment on relatively small Federal programs. Therefore, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:

(i) \$100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to \$100 million in total Federal awards expended. . . .

(e) Step 4. At a minimum, the auditor shall audit all of the following as major programs:

(1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2. . . .

(2) (i) High-risk Type B programs as identified under either of the following two options:

(A) Option 1. At least one half of the Type B programs identified as high-risk under Step 3 . . . , except this paragraph (e)(2)(i)(A) does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.

(B) Option 2. One high-risk Type B program for each Type A program identified as low-risk under Step 2. . . .

(f) Percentage of coverage rule. The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in § _____.530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

OMB Circular A-133 requires “major programs” to be determined utilizing a risk-based approach. If programs were not accurately selected, material noncompliance may occur and not be detected. In addition, the audit coverage may not be sufficient to allow the federal government to rely on the single audit to determine federal program compliance.

Recommendation

The CPA should utilize the risk evaluation process as outlined in OMB Circular A-133. The CPA should perform the audit in accordance with GAGAS and OMB Circular A-133.

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